



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence

Report of the auditor-general to the North West provincial legislature and the council on the Naledi Local Municipality

Report on the audit of the financial statements

Qualified opinion

1. I have audited the financial statements of the Naledi Local Municipality set out on pages xx to xx, which comprise of the statement of financial position as at 30 June 2017, and the statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget and actual amounts for the year then ended, as well as the notes to the financial statements, including a summary of significant accounting policies.
2. In my opinion, except for the possible effects of the matters described in the basis for qualified opinion section of my report, the financial statements present fairly, in all material respects, the financial position of the Naledi Local Municipality as at 30 June 2017, and its financial performance and cash flows for the year then ended in accordance with the South African Standards of Generally Recognised Accounting Practice (SA standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2016 (Act No. 3 of 2016) (DoRA).

Basis for qualified opinion

Property plant and equipment

3. I was unable to obtain sufficient appropriate audit evidence for property, plant and equipment due lack of implemented controls by the municipality to ensure that all infrastructure assets exist, land is separately recorded in the accounting records and no asset register being available for work-in-progress. I was unable to confirm these assets by alternative means. In addition, the municipality did not correctly account for depreciation in accordance with GRAP 17, *Property, plant and equipment* due to inconsistencies in the useful lives used in the calculation and work-in-progress completed but not depreciated. I was unable to quantify the full impact of the misstatement and the impact on the depreciation expense as it was impracticable to do so. Consequently, I was unable to determine whether any further adjustment relating to property, plant and equipment of R775 333 853 (2016: R764 305 144) disclosed in note 3 and to depreciation and amortisation of R35 892 345 disclosed in note 28 to the financial statements was necessary.

Receivables from non-exchange transactions

4. The municipality did not assess other debtors for conditions of impairment in accordance with GRAP 104, *Financial Instruments*, as the municipality did not maintain adequate records of these balances. In addition, the municipality did not assess receivables from non-exchange



transactions, traffic fines in accordance with iGRAP 1, *Applying the Probability Test on Initial Recognition of Revenue*. I was unable to determine the full extent of the overstatement of other debtors and understatement of impairments as it was impracticable to do so.

5. The municipality did not correctly record receivables from non-exchange transactions as the municipality recognised these balances in the wrong financial period. Consequently, accumulated surplus was understated and receivables from non-exchange was overstated by R2 254 464.
6. The municipality did not record the impairment for receivables from exchange and receivables from non-exchange transactions in accordance with GRAP 104, *Financial Instruments*. The municipality accounted for impairment for the prior year as R32 903 528 in notes 6 and 8 to the financial statement while the impairment for the prior year in the statement of financial performance was recorded as R42 065 033. Consequently, impairment for receivables for the prior year was overstated by R9 161 475 and accumulated surplus with the same amount.

Consumer debtors

7. The municipality did not assess consumer debtors in accordance with GRAP 104, *Financial Instruments*, as the municipality over impaired debtors at the reporting date. In addition, there was a quantifiable difference between the financial records and the underlining debtors subledger for consumer debtors. Consequently, consumer debtors was understated by R4 688 001 and service charges are understated by the same amount.
8. The municipality did not present as a minimum on the face of statement of financial position, receivables for exchange transaction and receivables from non-exchange transactions in accordance with GRAP 1, *Presentation of Financial Statements*. Property rates receivable to the amount of R5 870 701 (2016: R4 979 515) was disclosed as part of consumer debtors on the face of the statement of financial position. Consequently, consumer debtors are overstated and receivables from non-exchange transactions are understated by R5 870 701 (2016: R4 979 515).

VAT receivable

9. I was unable to obtain sufficient appropriate audit evidence for VAT receivable, as the municipality did not have adequate systems in place to account for reconciliations as well as adjustments made by the South African Revenue Services to VAT201 returns submitted. I was unable to confirm the balance by alternative means. Alternative procedures performed, indicated that VAT was not claimed for certain expenditure items, however I was unable to quantify the full extent of the misstatement as it was impracticable to do so. Consequently, I was unable to determine whether any further adjustment to the VAT receivable of R32 670 327 disclosed in note 7 to the financial statements was necessary.

Other income

10. The municipality did not account for contingent liabilities correctly as required by GRAP 19, *Provisions, Contingent Liabilities and Contingent Assets* as a legal claim was recorded as a provision during the prior periods instead of a contingent liability. Furthermore, the municipality incorrectly reversed the provision in the current year to other income. Consequently, accumulated surplus and other income was overstated by R20 409 355.

Payables from exchange transaction

11. I was unable to obtain sufficient appropriate audit evidence for payables from exchange transactions as the municipality did not maintain proper records of accounts payable. I was unable to confirm these payable by alternative means. In addition, payables from exchange transactions was understated by R12 866 278 as the municipality did not correctly account for debtors with credit balances, retentions, guarantees, expenditure not recorded and services rendered by suppliers which are currently under dispute not recorded as payables. Consequently, I was unable to determine whether any further adjustment to payables for

exchange transactions of R437 892 808 as disclosed in note 15 to in the financial statements was necessary.

Inventory

12. The municipality did not maintain adequate stock records to disclose inventory issued or received as part of inventory disclosure in accordance with *GRAP 12, Inventories*. I was unable to determine the full extent of the misstatement of disclosure of the inventory expense as it was impracticable to do so.

Service charges

13. The municipality did not correctly recognise all items of service charges in accordance with *GRAP 9, Revenue from Exchange Transactions* as not all transactions supported by billing reports were included in the financial records. Furthermore, the municipality did not correctly levy consumer debtors as incorrect tariffs were used for refuse, prepaid electricity, sewerage and sanitation as well as commission paid to the prepaid electricity service providers was incorrectly recorded against prepaid electricity income received instead of commission expenditure. Consequently, revenue from service charges was understated by R37 275 728, consumer debtors was understated with R20 974 454, payables from exchange transaction R12 144 278 overstated and commission paid understated by R4 156 995.

Property rates

14. The municipality did not correctly recognise revenue relating to property rates in accordance with *GRAP 23, Revenue from Non-exchange Transactions* due to various transactions being duplicated in the accounting records. Consequently, property rates and payables from exchange was overstated by R33 432 231.

Irregular expenditure

15. Section 125 of the MFMA requires the disclosure of irregular expenditure incurred. I was unable to obtain sufficient appropriate audit evidence for irregular expenditure relating to the previous years as no irregular expenditure register could not be provided. I was unable to confirm the irregular expenditure by alternative means. In addition, the municipality made payments of R26 516 839 in contravention with the supply chain management requirements which were not included in irregular expenditure disclosed. As the municipality did not quantify the full extent of the irregular expenditure, it was impracticable to determine the resultant understatement. Consequently, I was unable to determine whether any further adjustment relating to the irregular expenditure of R158 975 023 disclosed in note 45 to the financial statements was necessary.

Commitments

16. The municipality did not correctly disclosure commitments in terms of the accounting policy and as required by *GRAP 17, Property, plant and equipment*. Consequently, commitments as disclosed in note 37 to the financial statements was overstated by R27 674 228.

Context for the opinion

17. I conducted my audit in accordance with the International Standards on Auditing (ISAs). My responsibilities under those standards are further described in the auditor-general's responsibilities for the audit of the financial statements section of my report.
18. I am independent of the municipality in accordance with the International Ethics Standards Board for Accountants' Code of ethics for professional accountants (IESBA code) together with the ethical requirements that are relevant to my audit. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA code.

19. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified opinion.

Material uncertainty related to going concern/financial sustainability

20. I draw attention to the matter below. My opinion is not modified in respect of this matter.
21. I draw attention to note 42 in the financial statements, which indicates that the municipality incurred a net loss of R10 009 340 during the year ended 30 June 2017 and, as of that date the municipalities' current liabilities exceeded its current assets by R408 208 282. As stated in note 42, these events or conditions, indicate that a material uncertainty exists that may cast significant doubt on the municipalities' ability to continue as a going concern.

Emphasis of matters

22. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Restatement of corresponding figures

23. As disclosed in note 40 to the financial statements, the corresponding figures for 30 June 2016 have been restated as a result of an error in the financial statements of the municipality at, and for the year ended, 30 June 2017.

Uncertainty relating to the future outcome of exceptional litigation

24. With reference to note 38 to the financial statements, the municipality is the defendant in a land-claim lawsuit. The municipality is opposing the claim, as it believes the claim to be fraudulent. The ultimate outcome of the matter cannot presently be determined and no provision for any liability that may result has been made in the financial statements.

Unauthorised and fruitless and wasteful expenditure

25. As disclosed in note 43 to the financial statements, unauthorised expenditure of R28 227 765 was incurred in the current year and the unauthorised expenditure of R60 158 320 in respect of prior years had not yet been dealt with in accordance with section 32 of the MFMA.
26. As disclosed in note 44 to the financial statements, fruitless and wasteful expenditure of R35 127 494 was incurred in the current year and fruitless and wasteful expenditure of R61 832 324 from prior years had not yet been dealt with in accordance with section 32 of the MFMA.

Material losses

27. As disclosed in note 47 to the financial statements, material water losses to the amount of R7 934 847 (2016: R8 135 879) was incurred. Technical losses amounted to R1 968 389 (2016: R2 323 016) and were due to aged infrastructure and provision of water without measuring consumption in all areas where water is provided by Naledi Local Municipality. Non-technical losses amount to R5 905 167 (2016: R5 142 954) and were due to natural losses.
28. As disclosed in note 29 to the financial statements, material losses to the amount of R33 595 819 (2016: R42 065 003) were incurred as a result of impairment of receivables from exchange and non-exchange transactions.

Other matter

29. I draw attention to the matter below. My opinion is not modified in respect of this matter.



Unaudited disclosure notes

30. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon.

Responsibilities of the accounting officer for the financial statements

31. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with the SA standards of GRAP and the requirements of the MFMA and the DoRA Act and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.
32. In preparing the financial statements, the accounting officer is responsible for assessing the municipalities' ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless there is an intention either to liquidate the municipality or to cease operations, or there is no realistic alternative but to do so.

Auditor-general's responsibilities for the audit of the financial statements

33. My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.
34. A further description of my responsibilities for the audit of the financial statements is included in the annexure to the auditor's report.

Report on the audit of the annual performance report

Introduction and scope

35. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof I have a responsibility to report material findings on the reported performance information against predetermined objectives for selected development priorities presented in the annual performance report. I performed procedures to identify findings but not to gather evidence to express assurance.
36. My procedures address the reported performance information, which must be based on the approved performance planning documents of the municipality. I have not evaluated the completeness and appropriateness of the performance indicators included in the planning documents. My procedures also did not extend to any disclosures or assertions relating to planned performance strategies and information in respect of future periods that may be included as part of the reported performance information. Accordingly, my findings do not extend to these matters.
37. I evaluated the usefulness and reliability of the reported performance information in accordance with the criteria developed from the performance management and reporting framework, as defined in the general notice, for the following selected development priorities presented in the annual performance report of the municipality for the year ended 30 June 2017:

Development priorities	Pages in the annual performance report
Basic services and infrastructure Investment	x – x
Local economic development	x – x

38. I performed procedures to determine whether the reported performance information was consistent with the approved performance planning documents. I performed further procedures to determine whether the indicators and related targets were measurable and relevant, and assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
39. The material findings in respect of the usefulness and reliability of the selected development priorities are as follows:

Basic services and Infrastructure Investment

40. I was unable to obtain sufficient appropriate audit evidence for the selected development priorities below, due to a lack of technical indicator description or formal standard operating procedures or documented systems descriptions that predetermined how the achievements would be measured, monitored and reported, as required by the Framework for managing programme performance information (FMPPI). I was unable to confirm that the reported achievements of these indicators was reliable by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported achievements:

- Basic services and Infrastructure Investment

Local economic development

41. I did not identify any material findings on the usefulness and reliability of the reported performance information for this development priority.

Other matter

42. I draw attention to the matter below.

Achievement of planned targets

43. Refer to the annual performance report on pages xx to xx for information on the achievement of planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information in paragraphs xx to xx of this report.

Report on audit of compliance with legislation

Introduction and scope

44. In accordance with the PAA and the general notice issued in terms thereof I have a responsibility to report material findings on the compliance of the municipality with specific matters in key legislation. I performed procedures to identify findings but not to gather evidence to express assurance.
45. The material findings in respect of the compliance criteria for the applicable subject matters are as follows:

Budget

46. Reasonable steps were not taken to prevent unauthorised expenditure of R28 227 765, as disclosed in note 43 to the financial statements, in contravention of section 62(1)(d) of the MFMA. All of the unauthorised expenditure was due to overspending of the total amounts appropriated for various votes in the approved budget.

Strategic planning and performance

47. The performance management system and related controls were inadequate as it did not describe how the performance planning, monitoring, measurement, review and reporting processes should be conducted as required by regulation 7(1) of the Municipal planning and performance management regulations.

Annual financial statements and annual report

48. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of non-current assets, current assets, current liabilities, revenue and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records were provided subsequently, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.

Revenue management

49. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2) of the MFMA.

Expenditure management

50. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
51. Effective steps were not taken to prevent irregular expenditure, as required by section 62(1)(d) of the MFMA. The full extent of the irregular expenditure could not be quantified as indicated in the basis for qualification paragraph. The majority of the disclosed irregular expenditure was caused by non-compliance due to staff not adhering to SCM regulations.
52. Effective steps were not taken to prevent fruitless and wasteful expenditure of R35 127 494, as disclosed in note 44 to the financial statements, in contravention of section 62(1)(d). The majority of the disclosed fruitless and wasteful expenditure was caused by interest and penalties raised by suppliers.

Asset management

53. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.

Procurement and contract management

54. Some of the goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations, in contravention of by SCM regulation 17(a) and (c).
55. Quotations were accepted from bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
56. Competitive bids were not always evaluated by bid evaluation committees which were composed of officials from the departments requiring the goods and at least one SCM practitioner of the municipality, as required by SCM regulation 28(2).

57. Some of the contracts were awarded to bidders based on points given for criteria that differed from those stipulated in the original invitation for bidding, in contravention of SCM regulations 21(b) and 28(1)(a) and the Preferential Procurement Regulations
58. Competitive bids were adjudicated by a bid adjudication committee that was not composed in accordance with SCM regulation 29(2). This non-compliance was identified in the procurement processes for key projects for the upgrading of access roads in Greater Vryburg phase 1A and design and implementation of electrification in Vryburg ext. 28.
59. Some of the contracts and quotations were awarded to bidders based on preference points that were not allocated and calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act and its regulations.
60. Some of the contracts and quotations were awarded to bidders based on functionality criteria that were not stipulated and in the original invitation for bidding and quotations, in contravention of Preferential Procurement Regulations
61. Some of the contracts were extended or modified without the approval of a properly delegated official, in contravention of SCM regulation 5.
62. The performance of contractors or providers on key projects was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
63. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, in contravention of section 116(2)(c) of the MFMA.

Consequence management

64. Unauthorised, irregular and fruitless and wasteful expenditure incurred by the municipality were not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the MFMA.

Other information

65. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report. The other information does not include the financial statements, the auditor's report thereon and those selected development priorities presented in the annual performance report that have been specifically reported on in the auditor's report.
66. My opinion and findings do not cover the other information and I do not express an audit opinion or any form of assurance conclusion thereon.
67. In connection with my audit, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements and the selected development priorities presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
68. If, based on the work I have performed on the other information obtained prior to the date of this auditor's report, I conclude that there is a material misstatement of this other information, I am required to report that fact. I have nothing to report in this regard.

Internal control deficiencies

69. I considered internal control relevant to my audit of the financial statements, reported performance information and compliance with applicable legislation; however, my objective was not to express any form of assurance thereon. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for qualified opinion, the

findings on the performance report and the findings on compliance with legislation included in this report.

- The municipality's leadership did not exercise adequate oversight over financial and performance reporting, compliance monitoring and related internal controls. Policies and procedures did not adequately guide financial, performance and compliance activities as consequence management measures were not fully implemented.
- Management's internal controls and processes over the preparation and presentation of financial statements, performance reports and compliance monitoring were not able to ensure that the reports were free from material misstatements and material deviations from legislation. Numerous financial registers and schedules submitted by management did not agree to amounts as per the financial statements, was not complete for all items recorded and management did not adequately ensure the collection, collation, verification, storing and reporting of actual performance information.
- The audit committee and internal audit fulfilled their functions, however, management did not adequately respond to the concerns raised by the audit committee, and did not implement all the recommendations made by internal audit resulting in the internal control environment over financial and performance information and compliance with laws and regulations being ineffective. The previous mentioned resulted that audit committee and internal audit could not positively impact on the audit outcome.

Auditor-General

Rustenburg

30 November 2017



AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence

Annexure – Auditor-general's responsibility for the audit

1. As part of an audit in accordance with the ISAs, I exercise professional judgement and maintain professional scepticism throughout my audit of the financial statements, and the procedures performed on reported performance information for selected development priorities and on the municipalities' compliance with respect to the selected subject matters.

Financial statements

2. In addition to my responsibility for the audit of the financial statements as described in the auditor's report, I also:
 - identify and assess the risks of material misstatement of the financial statements whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
 - obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipalities' internal control.
 - evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the accounting officer.
 - conclude on the appropriateness of the accounting officer's use of the going concern basis of accounting in the preparation of the financial statements. I also conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Naledi Local Municipality ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements about the material uncertainty or, if such disclosures are inadequate, to modify the opinion on the financial statements. My conclusions are based on the information available to me at the date of the auditor's report. However, future events or conditions may cause a municipality to cease to continue as a going concern.
 - evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

Communication with those charged with governance

3. I communicate with the accounting officer regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.
4. I also confirm to the accounting officer that I have complied with relevant ethical requirements regarding independence, and communicate all relationships and other matters that may reasonably be thought to have a bearing on my independence and here applicable, related safeguards.